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Soviet Economic Development

The outstanding fact about the Soviet economy is its continued rapid growth. The traditional twin priorities -- investment in heavy industry and military preparedness -- have recently been joined by the consumer welfare program, with its emphasis on housing and agriculture. However, the shifts in resource allocation have had only a small, although perceptible, impact on economic growth.

Soviet gross national product ^{in the past few years} has been growing nearly twice as fast as that of the United States. Currently Soviet GNP is about 40 per cent that of the United States, but consumption (or what the consumer gets) is only about 25 per cent of U.S. levels. The USSR, by restricting consumption and concentrating on priority objectives, is able to challenge this country in important fields.

In terms of resources available for national policy purposes, which is to say for research, defense, industrial development, and foreign aid, the aggregate Soviet effort approaches that of the United States.

Military Expenditures

As far as military expenditures are concerned, we believe that the Soviets are spending about 170 to 180 billion rubles a year in total, compared to their announced expenditures of from 90 to 100 billion rubles. Our study of military pay and allowances,

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military construction costs and production costs leads us to believe that the so-called "explicit" Soviet defense expenditures cover only about 55 per cent of what total outlays must be. Very substantial outlays are buried under other headings in the Soviet budget. (Chart III)

Because of the rapid ^{growth} of the Soviet economy, military expenditures could rise ^{by 1962} to a level of about 220 billion rubles, or 40 billions more than at present, and still represent the same percentage of gross national product. (Charts I and II)

Chart V shows the estimated breakdown in broad categories for 1950, 1957, and 1962. The respective categories include the following:

Military personnel - expenditures for 1) pay and subsistence of all full time members of the Soviet army, naval, and air forces; 2) the militarized components of the MVD-KGB; and 3) subsistence for reservists on active duty.

Other personnel - expenditures for 1) civilian employees of the Soviet Ministry of Defense; 2) pensions for retired career military personnel; and 3) those payments to reservists met by their places of employment while they are on temporary active duty.

Research and development - all outlays for military research and development, including product development.

Materiel - all other outlays for Soviet military programs and activities.

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Industrial Development

Soviet industry, since the end of the Fifth Five Year Plan (1951-55), has reported slightly lowered annual rates of growth. Probably attributable, in part, to errors in planning which created an imbalance between capacity and production goals, especially in the basic materials industries, the slightly reduced current rates of growth probably will persist into the forthcoming Seven Year Plan period (1959-65). Additions to production capacity in the basic materials industries, which fell considerably short of planned goals in 1957, probably will not be great enough in 1958 to correct the imbalances ^{between raw material output and processing} which apparently had ^{Capacity} been developing since early in the Fifth Five Year Plan period. Therefore, continued efforts in this direction will be necessary beyond 1958. Furthermore, the greatly expanded housing program, achieved in 1957 and repeated in the plans for 1958, will continue to draw investment resources away from industrial investment, at least during the early years of the Seven Year Plan period. The possibility of rising investment costs and a slower rate of increase in the size of the industrial labor force may also operate to keep industrial production at slightly lower growth rates than enjoyed in the past.

Substantial overfulfillment of the unusually low planned increase in total industrial production in 1957 brought the reported actual rate of growth close to that achieved in the

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preceding year (Table 1), but the announcement of a planned rate of increase for 1958 nearly as low as the 1957 planned rate suggest that the Soviet planners may have some doubts about the possibility of overfulfilling the 1958 goals by as great a margin as in 1957. However, if the 1958 goals were to be overfulfilled by approximately the same degree as were those of 1957* as seems likely based on first quarter results, growth rates would be close to those originally contemplated in the now superceded Sixth Five Year Plan. It should be noted that the reported actual growth rate of producer goods in 1956 and 1957 is virtually as high as originally contemplated, but that of consumer goods is considerably below the original Sixth Five Year Plan rate, thereby reducing the likelihood of consumer goods production reaching the 1960 goals as originally scheduled. In spite of the abandonment of the Sixth Five Year Plan as a whole, statements have appeared recently in the Soviet press reaffirming the intention of reaching or exceeding the 1960 goals for some producer goods.1/ Such statements, of course, should be viewed in the context of probable substantial shortfalls in other producer goods, which have lagged seriously in 1956 and 1957.

* ORR has calculated a Soviet industrial production index employing official production data when available, official prices, and value added weights based upon official labor force and capital stock figures. The resulting trend closely confirms the trend of the official Soviet index, although the annual rates are somewhat lower than the official Soviet rates throughout the period measured.

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Table 1Soviet Industrial Production
Annual Rates of Growth

	Percent						
	<u>1951-55</u>	<u>1956</u>		<u>1957</u>		<u>1958</u>	<u>1958-60</u>
	<u>Average Annual Increase</u>	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Annual Rate Needed to meet Original 1960 Goals</u>
Total Industrial Production	13.1	10.5	10.7	7.0	10.0	7.6	10.7
Producer Goods	13.8	na	11.4	7.8	11.0	8.3	11.2
Consumer Goods	10.5	na	9.4	5.9	8.0	6.1	10.6

Industrial Reorganization

The reorganization of industry carried out by Khrushchev in 1957 has apparently gone along well. The abolition of the branch of industry ministries and the substitution of regional Councils of National Economy, or sovnarkhozy, was expected to create confusion and hamper production, at least during a short-term transition period. However, industrial production in the first quarter of 1958 rose 11 percent compared to the first quarter of 1957. This rate of increase was slightly higher than the annual rates for either 1956 or 1957.

The 1957 decentralization of operational decision making, as opposed to top policy decision making, was a sharp acceleration in a trend which began in 1954. The food and light industrial enterprises were among the first transferred from All-Union status to Republican ministries. By 1956, less than half of total

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industrial production remained under all-union ministerial control.

Gosplan has emerged as the most important economic planning organ, with responsibility for specifying current operational plans as well as long run future development programs. Also temporarily merged into Gosplan are the central marketing and supply organs formerly part of the industrial ministries. These continue the direct allocation of important materials within the economy, pending the overhaul of the supply system, one of the major goals of the reorganization.

Where before there existed neither effective mechanisms nor responsible agencies to assure regional coordination of planning, the new sovnarkhosi, together with the revitalized republic Gosplans, are performing integrated regional planning, as well as administration. At the enterprise level, greater freedom appears to have encouraged individual managerial initiative and resulted in improvements in efficiency.

Agriculture

The report of agricultural accomplishments in the 1957 plan fulfillment report, as in the 1956 report, contrasts much of the current performance with that of the undistinguished agricultural year 1953 -- a practice which obscures the fact that agricultural production in the drought year 1957 was disappointing to the Soviet leadership when compared directly with 1956. The grain harvest in 1957, although above that of 1953, was considerably below the 1956 level and probably below that of

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the more normal year 1955. Milk production in 1957 is reported to have exceeded the 1960 goal for yield per cow -- three years ahead of schedule -- but apparently there were not enough cows to permit total milk production to increase as rapidly as in 1956, or as rapidly as originally contemplated in Khrushchev's milk and meat program. Meat production apparently increased at a more rapid rate in 1957 than in 1956, but it too failed to keep pace with the rates implicit in the original milk and meat goals.

Adverse weather conditions in 1957 and underfulfillment of perennially unrealistic goals obscures the fact that the rate of growth of Soviet agriculture has risen significantly from the exceedingly slow growth rate of the Stalin era, when agricultural output barely kept pace with population growth. The average annual increase of about 7 percent achieved by Soviet agriculture since 1953 equals or exceeds the performance of any other agricultural economy over a short period of time. Although perhaps as much as half of this annual rate of increase can be attributed to the non-recurring impetus to growth provided by the "new lands" program, there is some likelihood that the USSR will be able to sustain a rate of growth in agriculture ~~substant~~ above that of the Stalin era. Capital investment in agriculture is continuing at an unprecedented rate and much of it is being directed toward increasing output by such means as reducing harvest losses and improving the timeliness of field operations.

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agricultural

The plan for 1958 calls for a 17 percent increase in gross agricultural production, which is a considerably higher rate of growth than generally achieved in past years and high relative to the scheduled rate of increase in inputs in agriculture. As such, successful fulfillment of the gross agricultural production goal in 1958 may depend to a larger extent than usual upon highly favorable weather conditions.

The 1958 plan calls for delivery of 165 thousand tractors to agriculture compared with 145 thousand in 1957, and 135 thousand grain combines compared with the delivery of 128 thousand in 1957, suggesting that the input of machinery and equipment to agriculture in 1958 will continue at the high levels of the past several years. The trend of agricultural production beyond 1958 may be affected favorably by the new emphasis upon a more efficient organization of agricultural inputs. The contemplated reorganization of the Machine Tractor Stations over the next few years will shift a considerable amount of capital, skilled labor, and management inputs from the MTS to the collective farms, with the expressed hope of obtaining a larger agricultural output from a given quantity of inputs. Under the new system, the amalgamation of most of the factors of production under the control of the Kolkhoz manager and the consequent reduction of the area of conflicting aims of the MTS director and the collective farm manager could result in an overall net gain to the agricultural effort, even though there may be some sacrifice of flexibility in resource use and a less intense use of skilled workers.

Foreign Trade

Soviet foreign trade has been increasing significantly ever since the death of Stalin. Over 70 percent of USSR trade turnover is still with other countries in the Sino-Soviet Bloc, of which China has been the largest single country. However, Soviet trade with the free world has increased 300 percent since 1950, as against an increase of 120 percent in its trade with other Bloc countries.

Approximately 75 percent of Soviet trade with the free world is with industrial countries, principally Western Europe. The largest imports from this area are ships and machinery and equipment. We expect that the upward trend in imports of machinery will continue. Recently, there has been considerable Soviet interest in the purchase of plants to manufacture consumer goods, such as artificial fibers and textiles.

At the same time, Soviet capabilities to export metals, such as aluminum, tin, zinc, and ferro-alloys, is increasing. We expect that sales of these metals will increase as well as those of petroleum, as a new means of acquiring the foreign exchange to pay for imports of machinery. In fact, the USSR in the next ten years may well become a major supplier of such products to Western Europe.

This seems particularly likely when Khrushchev's 1972 goals for certain commodities is examined. Take, for example, petroleum. The Soviets plan to produce between 350 and 400 million metric tons, approximately that of the United States at present. A crude calculation of USSR domestic consumption by that time shows that

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2 million barrels a day could be available for export. This compares with about 3 million barrels a day being consumed by all of Western Europe at present.

Sino-Soviet Bloc Economic Activities in Underdeveloped Areas

One of the principal characteristics of current Soviet policy is its stress on underdeveloped countries, in an effort to estrange them from the West and lay the groundwork for growing Soviet influence. In the needs of the new and underdeveloped countries of Asia and Africa for help in industrialization, the Soviet sees opportunities for influencing these states by providing assistance and by encouraging them to use Communist techniques. One of the principal Bloc weapons, has been the so-called "trade and aid" campaign, offering both arms and technical and economic aid on liberal credit terms.

By the end of 1957, the USSR and its satellites had extended credits and grants of nearly \$2 billion to underdeveloped countries. In addition, there are now several thousand Bloc technicians in these countries. While the total of Communist aid, economic and military, does not approach ours, they have concentrated on certain countries where they feel they can make the greatest impact - Egypt, Syria, Afghanistan, Indonesia, India, Yugoslavia, Ceylon, Burma and Cambodia. In these countries over the past three fiscal years, the aid program of the Bloc, including Communist China, has been greater than our own. Since the end of 1957, aid offers to Yemen have been stepped up sharply. In return, the Bloc has been willing to accept otherwise largely unsaleable raw

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material surpluses, an appealing feature of its program.

We have also seen a sharp increase in Sino-Soviet trade with the underdeveloped areas, which has been moving forward at a rate of 25 percent a year. This is to say that 1957 trade was about 50 percent higher than 1955.

The Soviet leaders are probably pleased with what they regard as their success to date, and will almost certainly intensify their efforts in this field. This program is now administered at the highest level in the USSR, the State Committee for Economic Relations, which is directly under the Council of Ministers. The USSR has the economic resources for a considerable expansion in its trade and aid program. Its extensive stocks of obsolescent arms will permit it to capitalize further on the desires of many underdeveloped countries to strengthen themselves militarily.

European Satellites

Introduction

Until 1953, the satellite economies grew rapidly under the Soviet-imposed heavy industrialization policy. At the same time, living standards were seriously depressed. Disturbances in the Soviet Zone of Germany and Czechoslovakia in 1953, and in Poland and Hungary in 1956 have combined to force a more realistic policy on the Communist leaders.

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The ruthless draining of the Satellite economies that occurred in the days of Stalin ^{has} ~~have~~ been checked. Industrial growth has been cut sharply and general welfare received more attention in the attempts to bring popular discontent under control. During 1956 and 1957, the USSR committed itself to extend \$1.2 billions in credits and aid, and cancelled an additional \$1.5 billions in debts. Largely as a result of this aid, the Satellite economies have recovered from the recent crises.

Living Standards

A good deal of our recent research on the European Satellites has been concerned with economic factors affecting stability. Of the various economic factors, ~~affecting political stability~~, the most obvious and important one is living standards. Difficult as it is to measure and evaluate changes in living standards in the Satellites, it seems safe to say that there have been gradual, though in some ways highly selective, improvements since 1953, whereas living standards were stagnant or deteriorating in every Satellite except ^{in the Soviet Zone of} ~~East~~ Germany in the early 1950's. The reversal of the earlier trend clearly is important, but the following considerations suggest that living standards remain a threat to the stability of these countries:

- (1) Living standards remain low compared with (a) what the Satellite populations expect as a result of their sacrifices since the war and the repeated promises of government and party leaders, (b) what is necessary to

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offset even partially the widespread dissatisfaction of the people with other features of the system that has been imposed on them, and (c) average standards of living in Western European countries, to which the populations have been exposed increasingly in recent years.

(2) Current living standards for the average person are not appreciably above the immediate prewar peak in any Satellite. In some Satellites, they may be somewhat below both the immediate prewar peak and an earlier post-war peak.

(3) A disproportionate share of recent gains in consumption has gone to farmers as a consequence of the necessity of raising procurement prices for agricultural products. Urban workers, whose hostility constitutes the principal internal threat to the regimes, have (except for selected groups, such as miners in certain countries) received much smaller benefits.

(4) Despite small over-all improvements in living standards since 1953, there still are serious deficiencies in the supply of food, clothing, and housing. The diet is generally low in quality (though not seriously deficient in terms of calories except in Albania) and takes a large part of the average family income. Housing conditions have been deteriorating in all of the Satellites, particularly in the urban areas of Poland, Rumania, and Bulgaria. These

remaining serious deficiencies may well be more important

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in determining popular attitudes than is the fact that supplies of food and clothing have been slowly improving.

(5) The push to collectivize agriculture in many countries may cause food output to be lowered. Of the total agricultural area, Bulgaria has now socialized over 90 percent, Czechoslovakia and Albania about two-thirds, Rumania over half, and the Soviet Zone of Germany over 40 percent. The trend is up in all these nations. In Hungary, it remains low, about 25 percent, and in Poland, of course, the trend has been reversed so that only about 10 percent of the agricultural area is still socialized.

POLAND

Recent Economic Policies of the Gomulka Regime

Since coming to power, the Gomulka regime has pursued economic policies aimed at increasing living standards, laying the foundations for a pattern of economic growth more in accord with Poland's particular circumstances, and eventually creating a more flexible economic system.

In pursuit of the first two goals, the Gomulka regime has reduced investments in heavy industry, and military and administrative expenditures, raised priorities for agriculture and housing, and obtained large foreign credits from the Bloc and the West.

Some of the policies in support of the third goal are a

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clear departure from the Soviet pattern of economic planning and management which had predominated in Poland since 1949. The most important changes to date have taken place in agriculture where most collective farms have been disbanded. Changes outside agriculture have been limited to a moderate growth of private handicraft and trade, to the development of worker's councils, and to some reduction in the amount of detailed State planning. Basic reforms of the planning and price systems, however, many of which are patterned after the Yugoslav system, are scheduled for 1959-60. These reforms would involve a considerable increase in the autonomy of State enterprises and the partial substitution of profit incentives for planning orders.

Prospects for the New Few Years

The greatest economic threat to political stability in the next 3 years lies in the probability that the rate of growth of personal consumption (assuming no large new foreign credits) will be much smaller than in any comparable period since 1953. Prospects for increases in per capita consumption of quality foods, durables, and handicraft products are good, but the very poor clothing situation will probably improve little, and housing conditions will probably continue to worsen. The regime will try to give urban workers most of the benefit from increases in consumer availabilities, but may not succeed in this, because of the power of private farmers to bid for higher farm prices. Given the severe

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existing dissatisfaction of most of the urban population and the effect of the October events on popular expectations, impatience with low living standards is more likely to grow than to abate in the next few years.

Even the moderate existing goals for increasing personal consumption presume large investments in housing, agriculture, light industry, and industries which provide inputs for these activities (construction materials, artificial fertilizer, agricultural machinery, synthetic fibers). Investments in these areas are planned to be much larger in absolute terms and as a share of total investments than in past years. Large reductions in other investments would release resources for consumption in the short run, but, particularly in the case of fuels, power and basic materials, would eventually depress the rate of economic growth. Of particular importance is the coal industry, where the failure to create enough productive capacity during the 6 year plan to meet increased domestic and export demands will have to be made good.

Another factor depressing the growth of consumption is the expected reduction in the availability of foreign credits, especially after 1958. By 1960, it is possible that repayments of previous foreign credits will exceed the balance of these credits available to Poland. Since the recovery of coal exports will inevitably be slow, and optimistic plans for extremely large increases in

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machinery exports are likely to be disappointed by strong competition in the underdeveloped markets and the poor quality of much of Polish machinery, the balancing of Poland's foreign trade will be very difficult and may even require cuts in investment and consumption from present planned levels.

Substantial stocks of grains and other materials accumulated during 1957 and the new U. S. loan greatly reduce the chances of a serious economic crisis in 1958. Whether the Polish Government will consider these resources to be adequate to risk proceeding further with basic economic reforms cannot now be predicted. However, it is clear that very large stocks are needed if the elimination of compulsory agricultural deliveries is not to cause a further rise in rural real incomes at the expense of urban real incomes, at least in the short-run, and if an industrial and distribution system allowing considerable autonomy to individual enterprises is to operate smoothly. Present information indicates that the Polish economic situation will become increasingly difficult during 1959-1960, although much depends on future developments in agriculture, the terms of foreign trade, and foreign credits. Existing foreign credits will create a very difficult repayment problem after 1960.

The planned pattern of economic development, with its reduced emphasis on metallurgy and machinery, would tend to facilitate to some extent a reduction in Poland's dependence on the Soviet

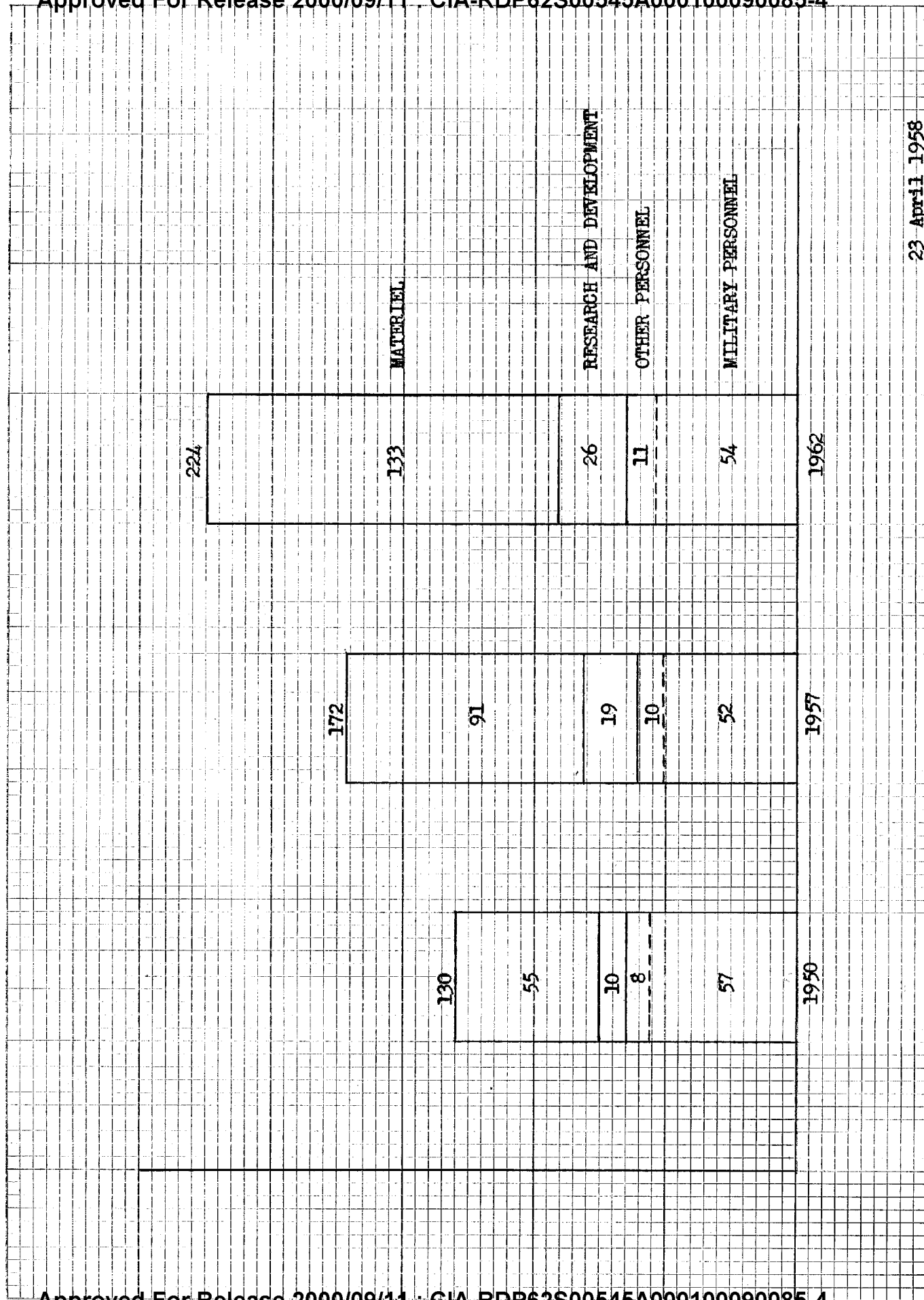
Union, though not necessarily on other Soviet bloc countries. On the other hand, some of the major Polish products which most readily find a market in Western Europe (particularly coal) will be in short supply over the next few years and it will take a long time to create a substantial production of manufactured goods saleable in the West outside underdeveloped countries. Moreover, since the USSR has been purchasing a large part of Poland's machinery exports, thereby supporting the machinery and metallurgical industries, which in turn depend primarily on Soviet deliveries of ore and parts, a significant decline in the Soviet Union's share of Polish foreign trade over the next few years does not appear likely.

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CHART V

BREAKDOWN OF ESTIMATED SOVIET MILITARY EXPENDITURES 1950, 1957, 1962
(billion 1 July 1955 rubles)



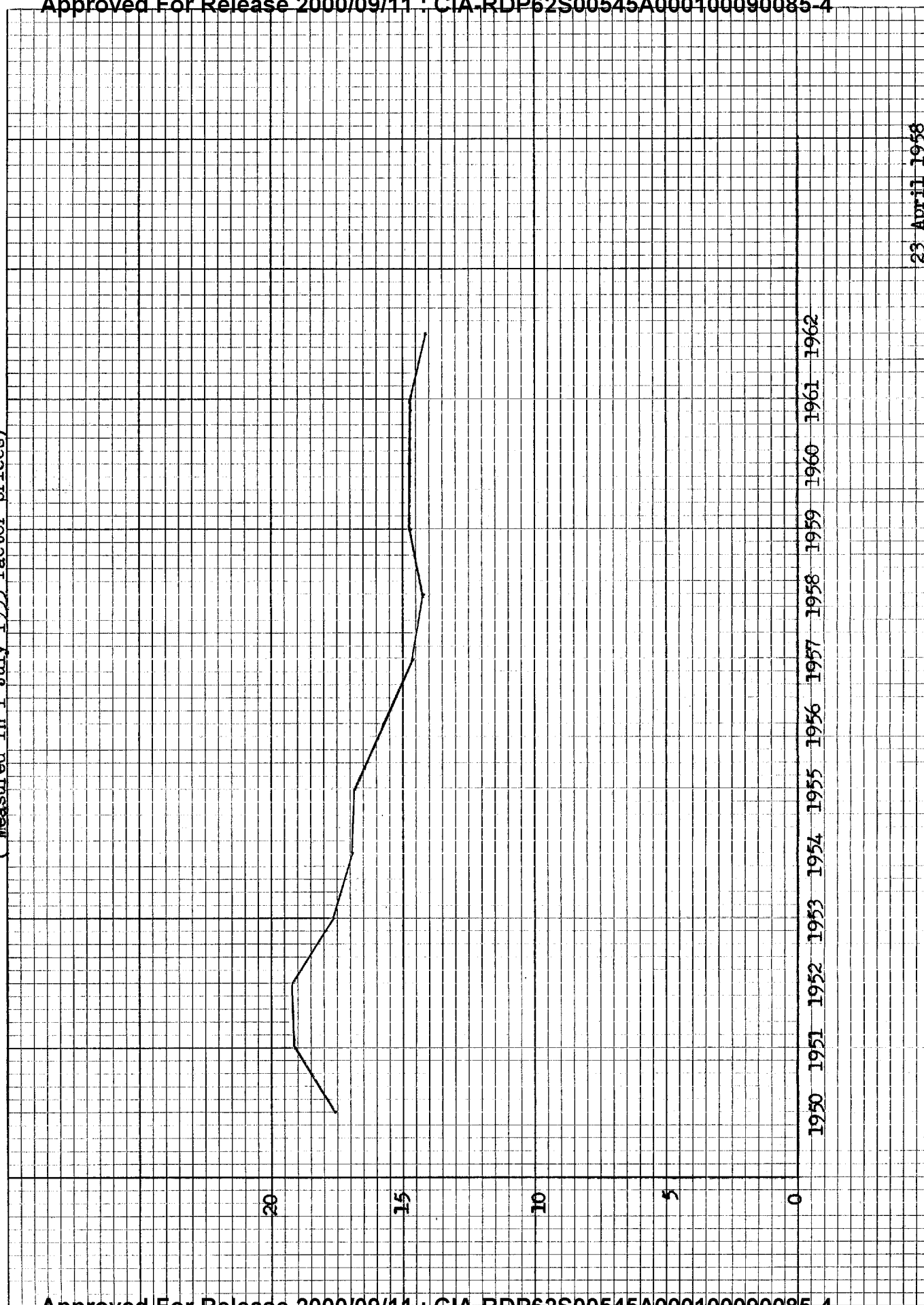
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CHART II
SOVIET MILITARY EXPENDITURES AS A PERCENTAGE OF GROSS NATIONAL PRODUCT
(Measured in 1 July 1955 factor prices)

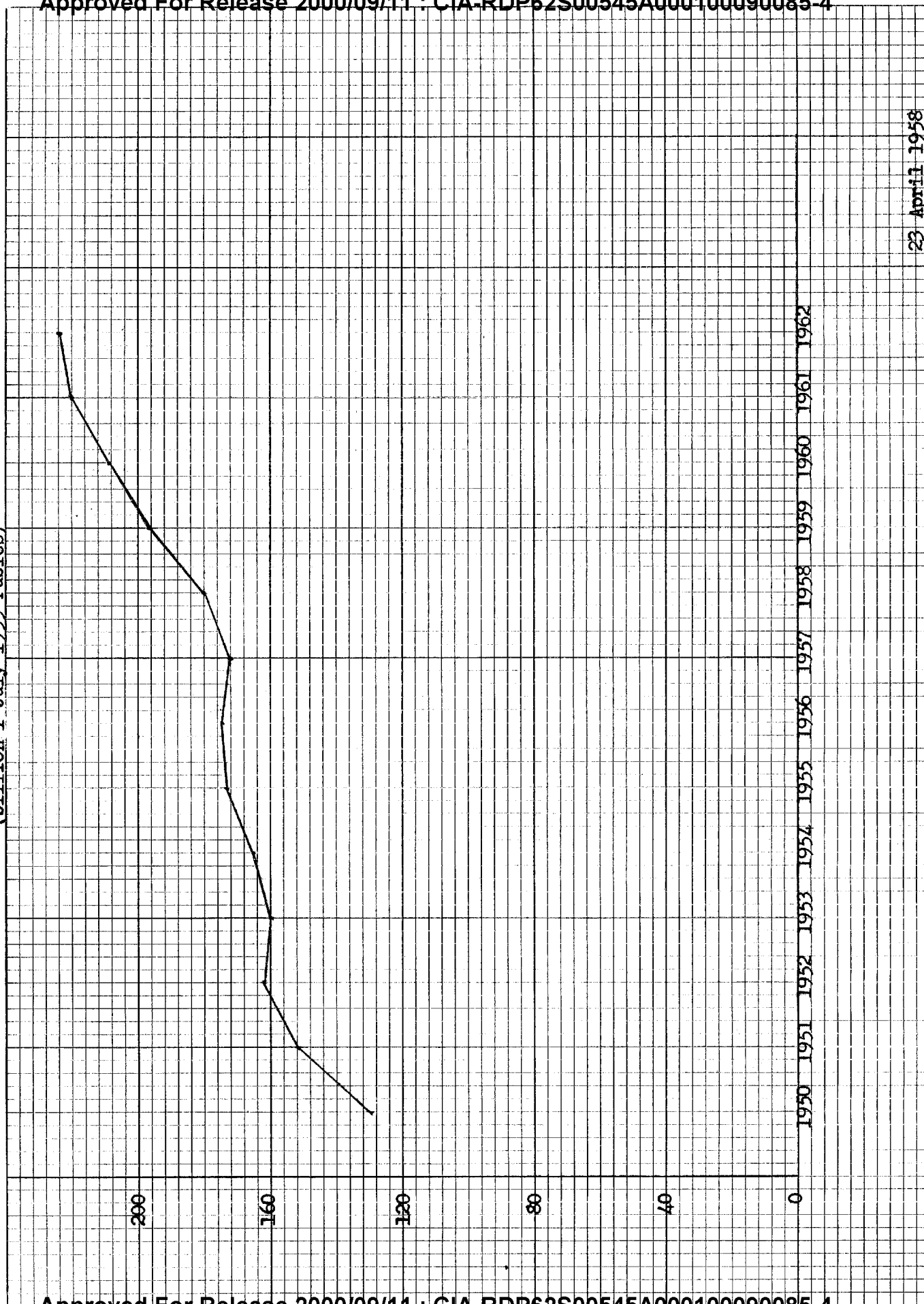


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CHART I
ESTIMATED TOTAL SOVIET MILITARY EXPENDITURES 1950-62
(billion 1 July 1955 rubles)



23 April 1958

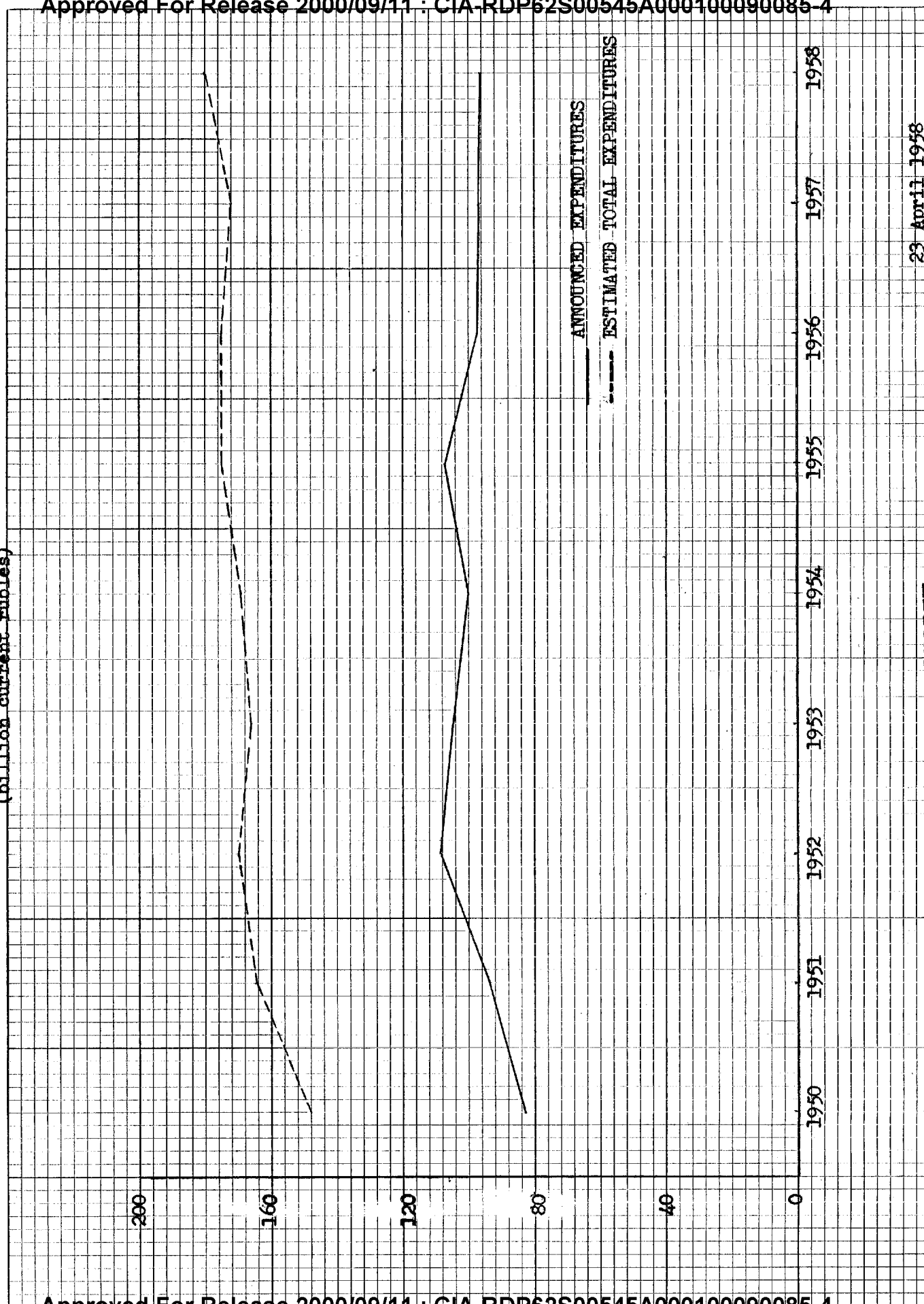
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CHART III

COMPARISON OF ESTIMATED TOTAL SOVIET MILITARY EXPENDITURES WITH THEIR
ANNOUNCED DEFENSE EXPENDITURES, 1950-58
(billion current rubles)

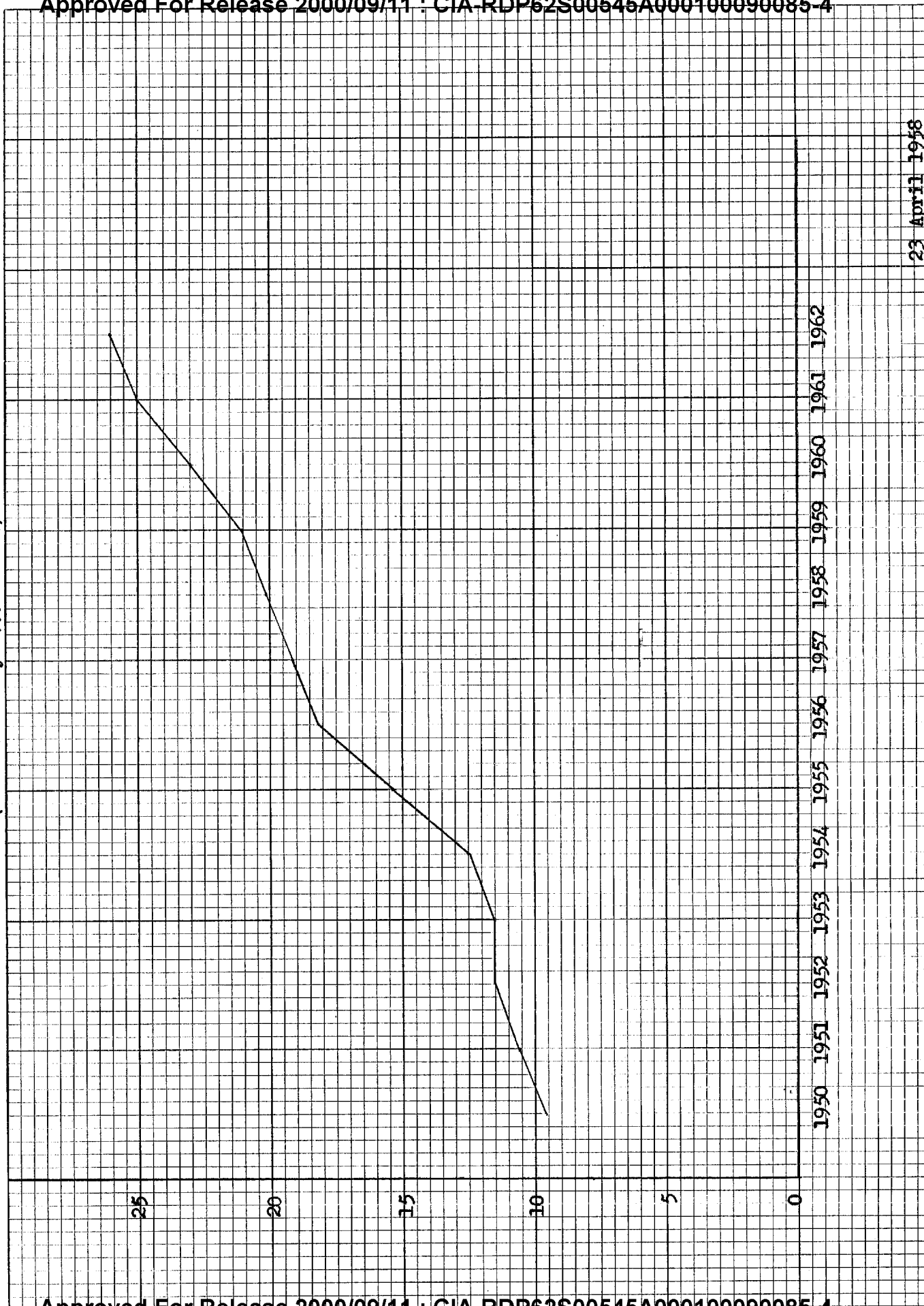


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CHART IV
ESTIMATED SOVIET EXPENDITURES FOR MILITARY RESEARCH AND DEVELOPMENT 1950-62
(billion 1 July 1955 rubles)



23 April 1958

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